

Moscow Financial Weekly

For the week ending November 1, 2002
Treasury Attache's office, US Embassy Moscow

Highlights

- Redraft of Deposit Insurance (Guarantees) bill completed
- **Weekly Focus:** Mutual Funds: A Growing Asset Class

Key Economic Indicators

Indicators	Level	% chg 1 week	% chg since Jan. 1
Ruble/\$ (MICEX) UTS	R31.7646	0.10	5.40
Monetary Base*	R844.5 bln	-1.53	19.20**
CPI	NA	NA	11.5
International Reserves*	\$46.4 bln	1.98	27.12
RTS Index (end of week)	357.45	2.44	37.45
Refinancing rate	23	0	4

*For week prior

** % chg from the abnormally high seasonal level at the end of the year.

Economic Developments

Last week the Emerging Markets Credit Association, which includes Morgan Stanley Dean Witter Investment Management, Pacific Investment Management, HBK Investment, Metropolitan Life Insurance and a number of other large funds, forwarded a letter to Moody's Investors Service asking for a delay in the likely upgrade of **Russia's sovereign rating** until the Russian government completes the FTO (foreign trade organization debt swap). The Association holds several hundred million dollars of this debt. The parties had agreed at the London Club that \$1.5 billion of this debt would be written off and the rest (\$2.5 billion) would be exchanged for Eurobonds. The Government has been promising to conclude the swap since 2001, but cites reconciliation difficulties as the cause for delay. In July 2002, the process finally began with a \$700 million swap into Euros-10 and Euros-30, with a continuation of swaps in September, but these did not occur.

In reply to creditors, Moody's said that completion of the FTO swap is not a prerequisite for a re-rating, but that the issue would be taken into consideration. It remains to be seen what weight Moody's will give to this factor in the overall rating, however. Meanwhile, there are rumors that the Finance Ministry might be ready to make an offer to swap the total adjusted sum of \$1.1 billion before November 15, with the actual transactions to be concluded by the end of the year.

WEEK OF NOVEMBER 1, 2002

Banking sector

On October 31 the Ministry of Economic Development and Trade (MEDT) finally completed the new draft version of the **deposit insurance bill** and the next day the document was officially passed to the GOR. The GOR is expected to discuss this draft on November 14. MEDT Deputy Minister Arkady Dvorkovich and CBR First Deputy Chairman Andrei Kozlov both agreed that changing the name from "guarantees" to "insurance" did not significantly change the concept of the bill, and was done only to eliminate the contradictions with existing legislation noted by Kremlin lawyers. Insurance companies will not be part of the proposed mechanism. However, bank premiums/contributions will be accumulated in and managed by the Agency for Restructuring Credit Organizations (ARCO). Initial contributions in the amount of R3-5 billion will be made from the Federal budget, which would require the law on the 2003 budget be amended.

According to Goskomstat, as of September 1, 2002, **household deposits** in Russian banks, both in ruble and foreign currency accounts, totaled R923.3 billion, which is 31% larger than at the beginning of this year and 50% more than on September 1, 2001. The sum of household deposits in Sberbank increased since the start of the year by 27.8% to R640.6 billion; however, Sberbank's share of total of household deposits went down by 2 percentage points to 69.4%. The sum of ruble deposits in all Russian banks increased during the first eight months of 2002 by 26%, but the sum of foreign currency accounts grew faster during the same period, increasing by 41.7%. On September 1, 2002 bank deposits accounted for 45.1% of total household monetary savings, estimated by Goskomstat at R1249.3 billion. Cash on hand accounted for 36.6%, while securities made up the remaining 18.3%.

The revised version of the **CBR's instruction on consolidated bookkeeping** brings banks' accounting closer to full adoption of international standards beginning in 2004. According to the instruction, all securities need to be separated among three portfolios: trade, investment and "securities on hand for sale". Assets should be shown in the balance statement net of respective reserves. In addition, a single unified limit for the open currency position is introduced for both balance and off-balance positions. The new requirements come into force on November 11, ten days after the October 31 publication.

Shares of 121 credit institutions worth R1.15 billion at par, which used to be owned by state unitary enterprises (a.k.a. GUPs), have been transferred to the Ministry of State Property. This is the first such transfer of **GUP banking shares** to the Ministry, after which the shares will be sold to the public. The actual shares transferred include a 2.7% stake in National Reserve Bank, a 0.37% stake in Vozrozhdenie Bank and 1,600 Sberbank shares. The Ministry also received shares of banks that had been declared bankrupt in court, such as Inkombank and Promstroybank of Russia. The next step will likely be a transfer of bank shares owned by the GUPs' subsidiaries and affiliated entities to the Ministry.

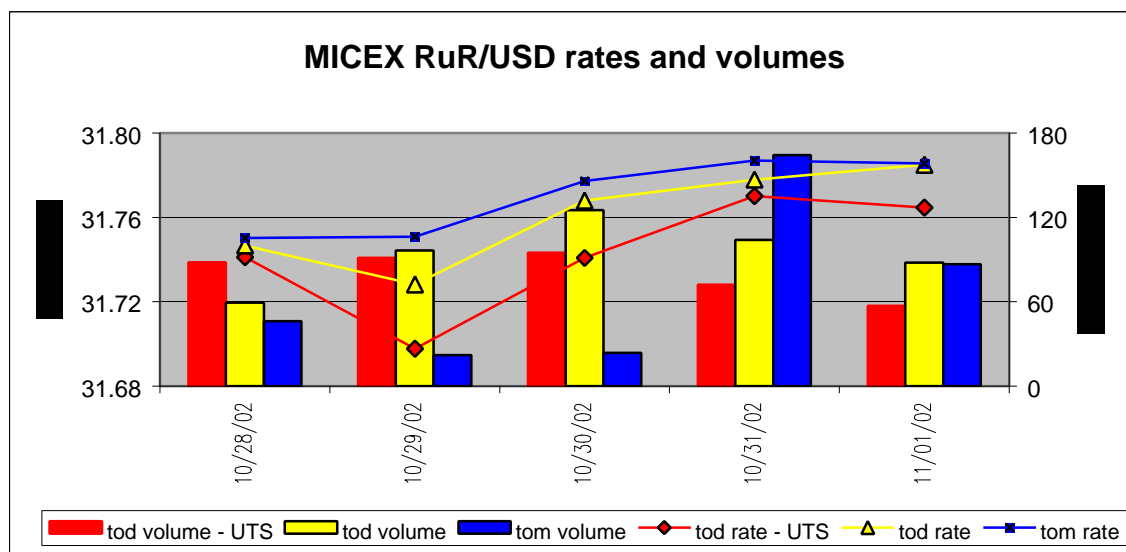
CBR First Deputy Chairman Andrei Kozlov said the CBR's Banking Supervision Committee issued **MDM Bank** a permit to purchase a 99% stake in Latvian Trade Bank (LTB). According to Julian Krasnopolsky, Deputy Chairman of MDM Bank, his bank already owns 99% of LTB which soon will be renamed into MDM-Latvia. The CBR's permit therefore effectively legalized the MDM's existing ownership of LTB. Krasnopolsky also said that MDM does not plan to buy any more banks in the Russian regions. The last such regional bank bought by MDM Bank was Ural-Siberian Social Development Bank (USSDB). The USSDB shareholders meeting scheduled for November 12 will consider the issue of renaming it to MDM-Ural.

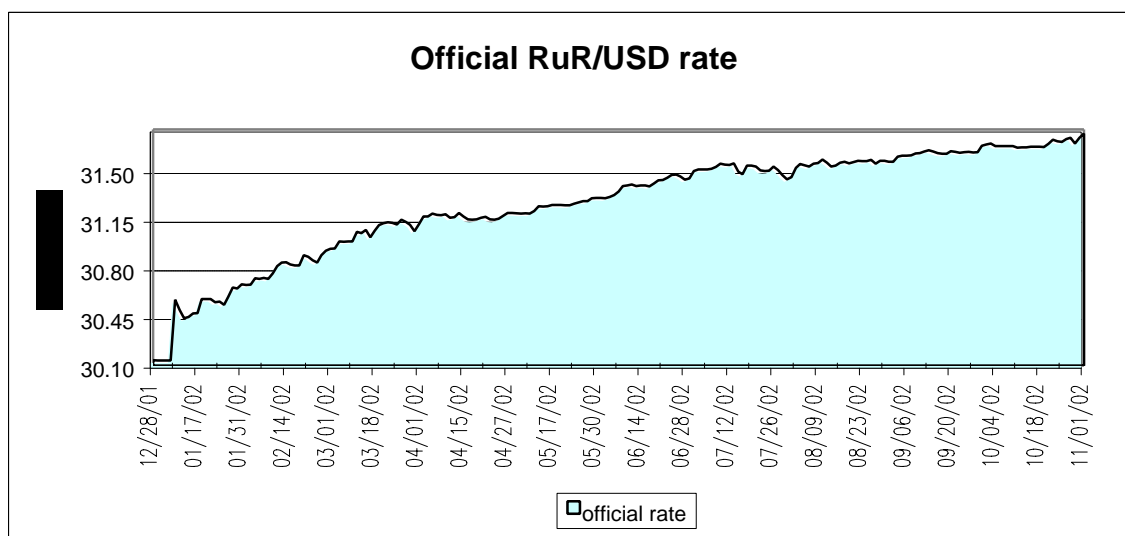
Financial markets

Forex Market

Last week the ruble/dollar exchange rate was unusually volatile. The end-of-month ruble strain pushed the ruble up against the dollar in Monday afternoon MICEX trading and the next morning in the UTS ruble appreciation exceeded 4 kopeks, the highest in the last 3 months. On Wednesday ruble liquidity began to grow again and in the UTS the ruble fell back Monday's level, then continued to slide in the afternoon. It dropped another 3 kopeks on Thursday morning and would have continued to fall had the CBR not intervened at R31.785-R31.790/\$. That day banks bought up to \$250 million from the CBR. On Friday the CBR maintained the previous day's policy and the ruble inched up against the dollar in the UTS, stabilizing around the level set by the CBR in afternoon trading.

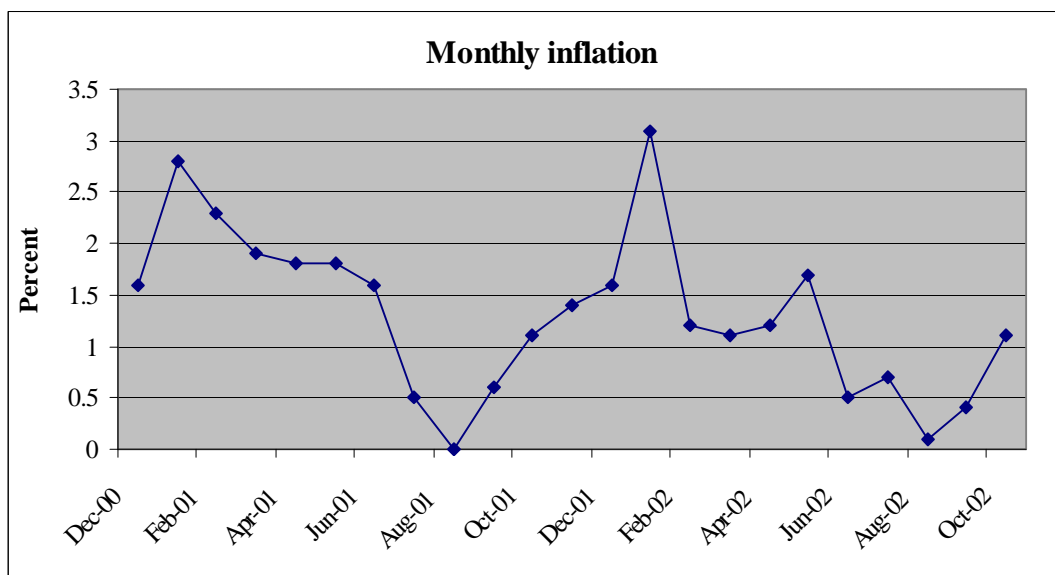
For the week, the ruble weakened against the dollar 0.10%, closing in the UTS on Friday at R31.7646/\$. MICEX weekly trade volumes were \$403.16 million, \$472.76 million and \$342.73 million for the morning (UTS), afternoon "tod" and "tom" sessions, respectively.





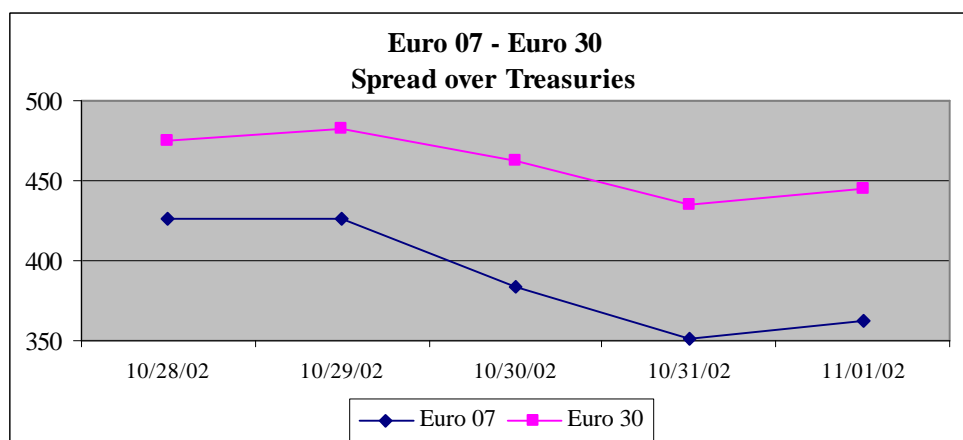
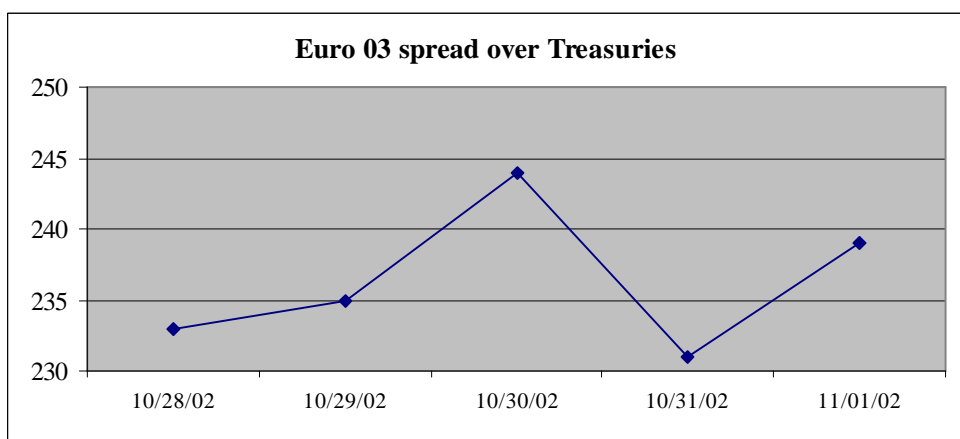
Prices

According to Goskomstat, inflation for the month of October was 1.1%, resulting in 2002 year to date inflation of 11.5%. In October inflation was again affected by increased services prices -- up by 2.5%, while inflation in the foodstuffs sector was 0.6% and in non-foodstuffs - 0.9%. From January-October 2002, consumer services prices rose by 32.3% a significant increase, while foodstuffs prices increased by 6.5% and non-foodstuffs by 9.2%. In the waning months of the year, inflation will likely accelerate due to seasonal monetary factors as well as PPI growth.

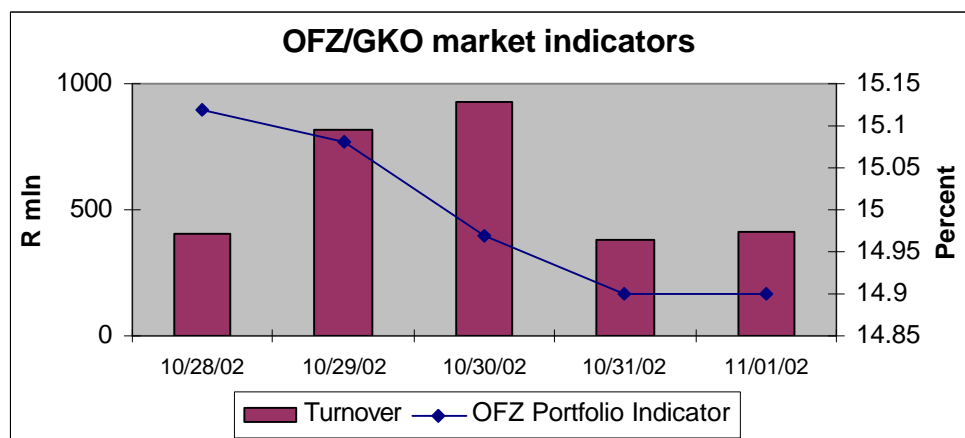


Eurobonds

News of the expected improvement in Russia's sovereign rating and the resulting appreciation caused Russian Eurobonds to soar last week. On Thursday, new historic highs were recorded with the Euro-30 reaching 77% of par. The next day, a natural downward correction took place, bringing the Euro-30 price down to only 76% of par.

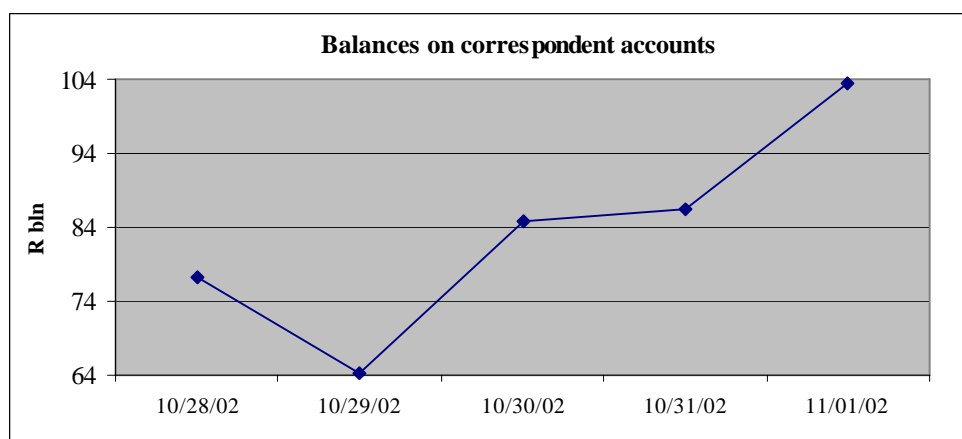
Interest/Bond Market*Bonds/Bills*

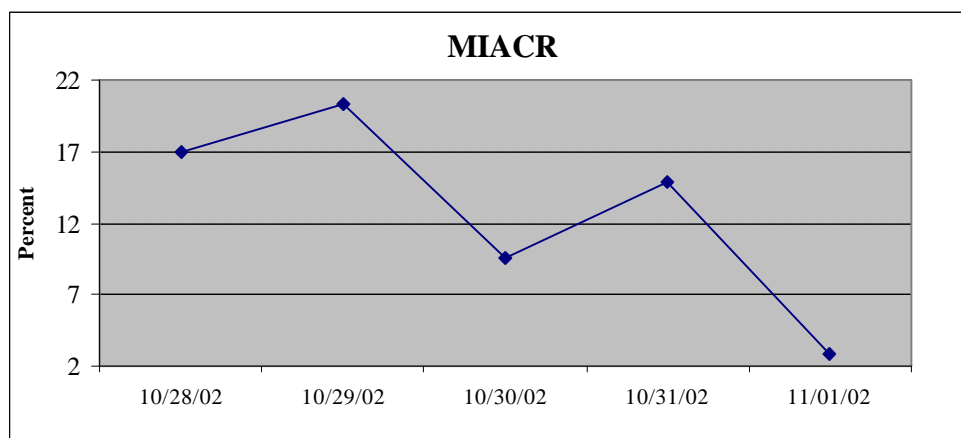
The secondary GKO/OFZ market opened down on Monday due to tightened ruble liquidity. However, the next day yields of practically all bonds and bills began to decrease, particularly the longer-term instruments. Government paper was particularly in demand from players who had no shortage of rubles and who were expecting the traditional increase in debt prices at the beginning of the month.



Overnight rates

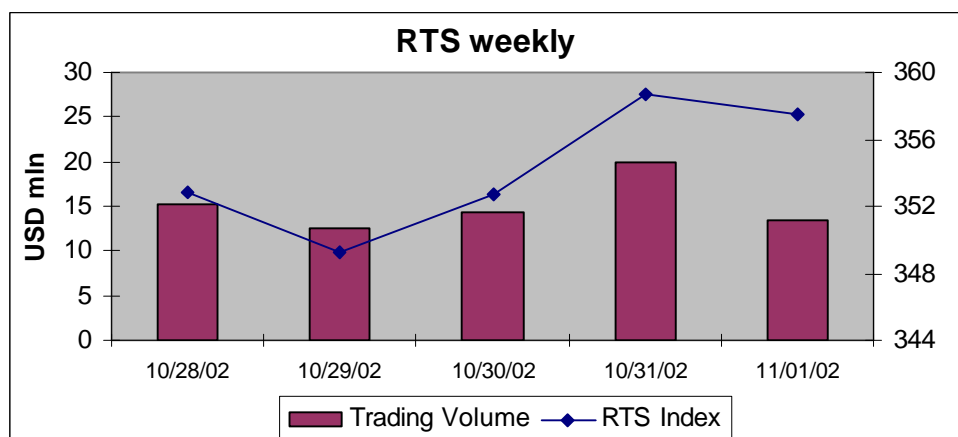
The end-of-the-month factor (when banks have to make obligatory tax payments for their clients) was especially noteworthy last week. The overnight rates started the week up at 25% p.a., increasing to 30% on Tuesday, while the balances on the banks' correspondent accounts at the CBR were down by R13 billion, for a total of R64.3 billion. The next day there was some relief in terms of liquidity, with the balances notching up by R20.6 billion and overnight rates fluctuating between 6-15% p.a. throughout the day. The last spike in rates happened on Thursday, although balances remained at around R86.3 billion. On Friday, the rates were down to 2-3% and the balances jumped up by R17 billion, flooding the market with rubles.

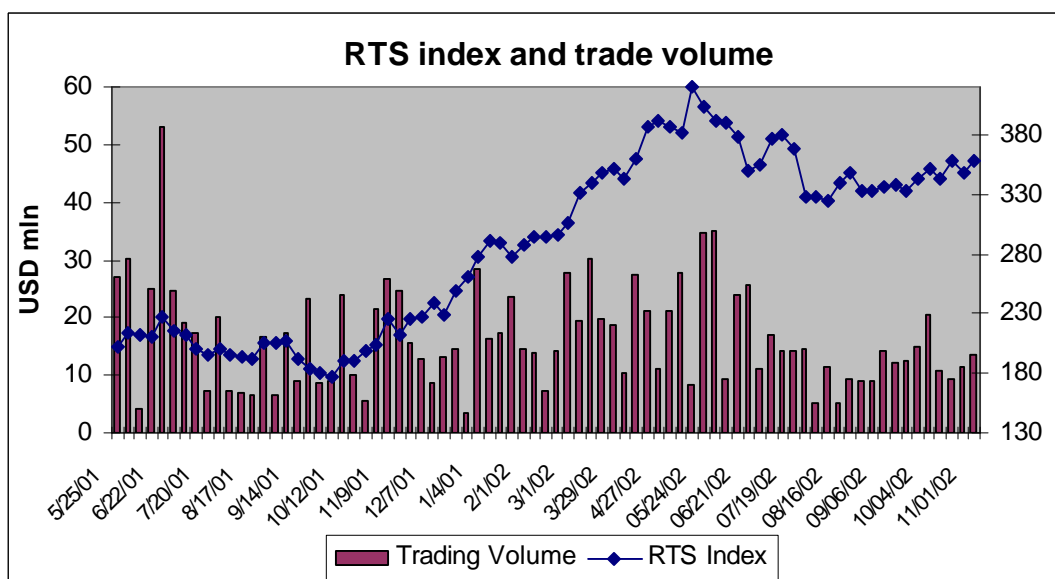
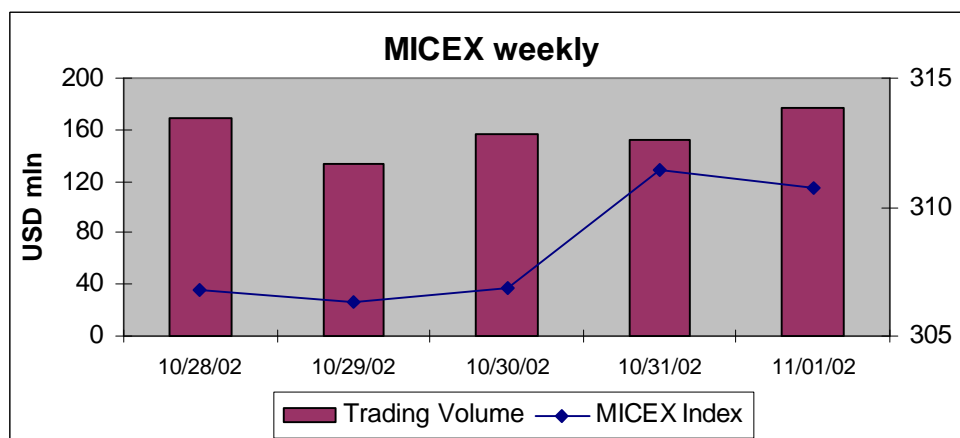




Stock Market

The stock market opened up higher on Monday with the news of the hostages' release. Increases in the U.S. market added to the positive mood that day as well. However, the next day the market corrected downward, as there was no positive news within the country and the market followed downward trends in foreign markets. During Wednesday and Thursday, share prices increased on the positive news from the Eurobond market, where Russian bonds hit historic highs. These increases were followed by a slight downward correction on Friday. Low volumes that day shows that most players chose to remain on the sidelines. Throughout the week, the energos were highly demanded (UES and Mosenergo), while oil company shares did not fall as much as they might have given the news of lower oil prices. For the week, the RTS index was able to recover after last week's fall and was up by 2.5% in dollar terms.

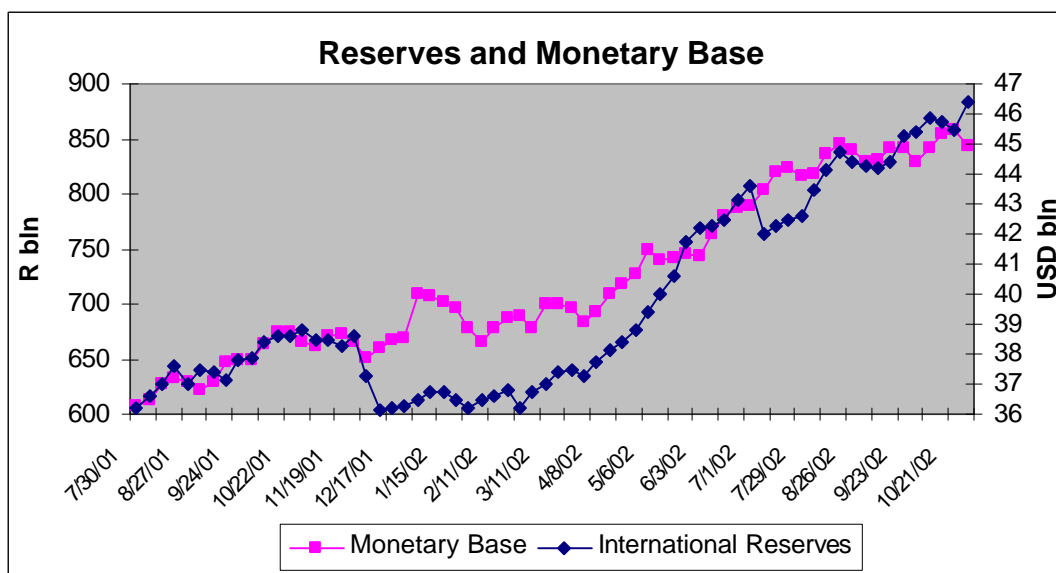




International Reserves and Monetary Base

International reserves increased by as much as \$900 million as of October 24, reaching a new record high of \$46.4 billion. This follows reserve losses of \$400 million during the previous two weeks and represents a departure from the recent downward trend. This is the fourth such weekly increase in 2002, with the record being a \$1.1 billion increase during the third week of May. This recent increase is likely due to two factors: unusually large export receipts caused by higher oil prices in late August (there is an approximate three-month delay in obtaining export proceeds) and the CBR's decision not to intervene in the forex market that week.

The monetary base decreased last week after a 3-week climb. It stopped at R844.5 billion, down R13.1 billion for the week.



EXPLANATORY NOTES

1. EXCHANGE RATES: SELT - "System of Electronic Lot (currency) trading" -- a computer based OTC-style trading system organized by the Moscow Interbank Currency Exchange (MICEX). MICEX Unified Trading Session (UTS) is the one in which exporters have to sell 50% of the repatriated currency. UTS fix (rounded) becomes the "official" ruble rate for the next day. "\$-tod" price is the price of the dollar with same day delivery. "\$-tom" is the price of the dollar with delivery on the next day. Minimum lot size for each of the dollar instruments is \$100,000. Average price is quoted as the weighted average of all actual deals entered into the system by various banks.

2. INTEREST RATES: Moscow InterBank Actual Credit Rate is calculated as the average-weighted rate on the volume of actual transactions in interbank loans by commercial banks.

3. STOCK INDICES: The RTS index is the only official indicator of the Russian Trading System. It is calculated every 30 minutes of the RTS trade session, starting at 12:00. It comprises 60 shares of 35 leading companies. These shares are included in so-called Category "A" listings. The index indicates over-the-counter stock prices. The index represents the ratio of the total market capitalization of the shares of the companies selected for the index to the total market capitalization of the same shares as of the initial date multiplied by the index value as of the initial date (31 December 1997) using a base of 100 beginning September 1, 1995. The ruble-adjusted index is a derivative of the main dollar index, using the same base. The MICEX index is calculated by the stock section of the Moscow Interbank Currency Exchange and is based on the price fluctuations of 17 shares of the MICEX's first and second listings.

4. INTERNATIONAL RESERVES OF THE RUSSIAN FEDERATION represent the amount of reserve assets of the Bank of Russia and Finance Ministry. Those reserve assets are comprised of monetary gold, special drawing rights, the reserve position in the IMF and other liquid foreign assets. The latter include short-term deposits in non-resident and resident banks, balances in current accounts, foreign government securities, repo agreements with these securities made with non-residents, and other liquid assets (accrued interest on these assets is not included). Monetary gold is evaluated at a floating rate, revised periodically, but not always reported immediately. Foreign currency assets are converted into U.S. dollars on the basis of the cross rates of foreign currencies to the dollar, calculated using the official rates of the ruble to these foreign currencies, as set by the CBR.

5. MONETARY BASE (M1) is comprised of cash and reserves of commercial banks on deposit in the CBR. It is the basic part of the money supply (M2).

6. LOMBARD CREDITS, distributed through auctions, are aimed to provide liquidity to the banking sector. These credits are extended to banks on the basis of collateral.